

8 August 2019

United States

EQUITIES

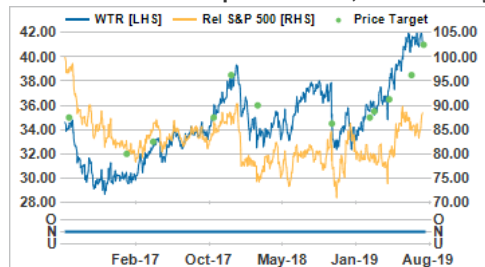
WTR US Neutral
Price (at 22:52, 07 Aug 2019 GMT) US\$42.06

Valuation	US\$	41.44
- PER		
12-month target	US\$	41.00
12-month TSR	%	-0.3
GICS sector		Utilities
Market cap	US\$m	9,072
30-day avg turnover	US\$m	37.3
Number shares on issue	m	215.7

Investment fundamentals

Year end 31 Dec		2018A	2019E	2020E	2021E
EPS adj	US\$	1.41	1.30	1.54	1.68
EPS adj growth	%	4.5	-7.3	17.8	9.1
PER adj	x	29.9	32.3	27.4	25.1
Total DPS	US\$	0.85	0.91	0.97	1.04
Total div yield	%	2.0	2.2	2.3	2.5

WTR US rel S&P 500 performance, & rec history



Note: Recommendation timeline - if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, August 2019

(all figures in USD unless noted)

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Aqua America (WTR US)

Pipe dream

Key points

- As a pure-play water utility, WTR would likely be trading 12% higher than currently.
- Peoples deal seemed based on repair tax deduction, but WTR is still studying it.
- Then again, repair tax deduction would just pull forward future earnings.

Event

- We've been watching WTR's pursuit of a gas utility from afar. For now, it seems like WTR's stock would likely be trading 12% higher than currently if the company had just remained a pure-play water utility. The repair tax deduction at Peoples Gas in PA could change the math, but that's likely months away.
- WTR's 2Q19 EPS of US\$0.37 was in line with consensus, but excluded a US\$0.02 dilution related to the higher share count associated with the Peoples deal. Inclusive of the dilution, WTR's results were in line with our US\$0.35 expectation.

Impact

- A trade-off between PE and EPS growth:** For the five years before the Peoples deal announcement, WTR traded on par with AWK on FY2 PE, though WTR grew EPS at a 4% CAGR over this period and AWK at almost 9%. If WTR had remained a pure-play water utility growing at 4-4.5% annually and the PE parity persisted, we estimate WTR would now be trading at ~US\$47/share or almost 12% higher than yesterday's close. WTR currently trades at a 10% '20 PE discount to AWK on our US\$1.54/sh '20 proforma EPS, though the deal is EPS neutral then.
- Repair tax deduction at Peoples:** The diversification into the gas sector was widely expected to weigh on WTR's PE multiple, but in exchange was to align WTR's EPS growth with the 7% water rate base growth, which should happen by '21, we believe. The growth rate could be even higher depending on the repair tax deduction in PA for Peoples, but for now the US\$265m (and counting) in deal fees hasn't created much shareholder value, we believe. Peoples Gas' rate case settlement in PA does not include a repair tax deduction, and WTR plans to pursue it only in '20 once it completes the assessment of how much of Peoples' capex would qualify for repair tax expensing. The repair tax was likely the core assumption underpinning the deal's EPS accretion.

Earnings and target price revision

- We raise our estimates to reflect a lower fully diluted share count assuming conversions of tangible equity units at higher stock prices. Our new '19/'20/'21 EPS estimates are US\$1.30/1.54/1.68 vs US\$1.30/1.51/1.65 previously. We raise our TP to US\$41 from US\$38.50. The TP remains based on 1.4x our '21 PE anchor for electric utilities for water and 1.2x for WTR's gas business.

Price catalyst

- 12-month price target: US\$41.00 based on a PER methodology.
- Catalyst: Analyst day (Dec 5).

Action and recommendation

- We reiterate our Neutral rating.

Please refer to page 4 for important disclosures and analyst certification, or on our website www.macquarie.com/research/disclosures.

Fig 1 WTR: EPS proforma pending Peoples merger

	2019E	2020E	2021E	2022E
Water net income (US\$m)	261.87	274.25	288.13	305.00
Gas net income (US\$m)	48.14	146.16	167.76	184.54
Incremental parent interest expense after tax (US\$m)	-10.5	-31.9	-31.6	-36.0
Total EPS (US\$)	1.30	1.54	1.68	1.79
S/O (m)	230	253	253	253
EPS accretion vs standalone EPS (US\$)	-0.16	0.00	0.06	n/a
Water EPS	87%	71%	68%	67%
Gas EPS	13%	29%	32%	33%
Water EPS (US\$)	1.14	1.08	1.14	1.21
Water PE multiple		27.2x	25.9x	24.6x
Equity value of water per share		29.48	29.50	29.66
Gas EPS (US\$)	0.16	0.45	0.54	0.59
Gas PE multiple		23.8x	22.2x	20.6x
Equity value of gas per share		10.73	11.95	12.12
Total equity value per share		40.21	41.44	41.78

Source: Macquarie Capital (USA), August 2019

Fig 2 WTR: Financial projections (US\$m except per share data)

	2018	2019E	2020E	2021E
EBITDA	470	605	765	821
EBIT	323	453	602	649
Net interest expense	99	125	163	162
Ordinary Profit Before Tax	252	351	462	510
Income tax	1	51	74	85
Net profit	251	300	389	424
S/O (m)	178	230	253	253
Diluted EPS	1.41	1.30	1.54	1.68
DPS	0.85	0.91	0.97	1.04
Cash	5	716	293	5
Receivables	101	128	148	156
Inventory	14	18	18	18
Other short-term assets	16	16	16	16
Other-long term assets	801	801	801	801
Property, plant, and equipment	5,808	6,206	6,473	6,731
Total assets	6,746	7,884	7,749	7,727
Financial liabilities	117	117	117	117
Operating liabilities	64	81	82	84
Other liabilities	108	108	108	108
Deferred credits	2,096	2,110	2,124	2,138
Long-term debt	1,975	2,254	2,248	1,904
Shareholders' equity	2,385	3,214	3,069	3,376
Total liabilities and equity	6,746	7,884	7,749	7,727
Net income	251	300	389	424
D&A, goodwill amortisation	147	152	163	172
Other non cash elements	25	25	25	25
Funds from operations	423	477	577	622
Non-cash working capital	8	43	22	9
Operating cash flow	430	521	600	631
Net investments in fixed assets	-555	-550	-430	-430
Net investments in financial assets	0	0	0	0
Free cash flow before dividends	-125	-29	170	201
Dividends paid	-151	-209	-246	-263
Free cash flow after dividends	-276	-238	-76	-62
Changes in capital	2	1,298	2	2
Changes in financial debt	273	-350	-350	-228
Adjustment for minorities / miscellaneous	1	1	1	1
Increase in cash	1	711	-423	-288

Source: Company data, Macquarie Capital (USA), August 2019

Stocks mentioned:

American Water Works (AWK US, US\$117.42, Outperform, TP: US\$121.00)

Macquarie Quant Alpha Model Views

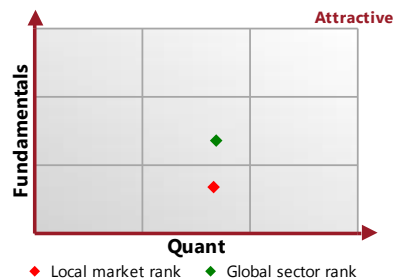
The Quant View page below has been derived from models that are developed and maintained by Sales and Trading personnel at Macquarie. The models are not a product of the Macquarie Research Department.

The quant model currently holds a marginally positive view on Aqua America. The strongest style exposure is Price Momentum, indicating this stock has had strong medium to long term returns which often persist into the future. The weakest style exposure is Valuations, indicating this stock is over-priced in the market relative to its peers.

197/448

Global rank in
Utilities

% of BUY recommendations 67% (6/9)
Number of Price Target downgrades 0
Number of Price Target upgrades 2

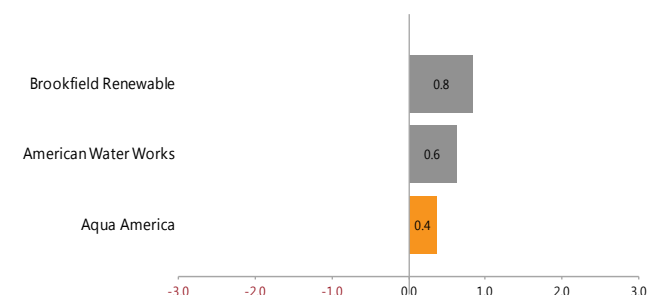


Displays where the company's ranked based on the fundamental consensus Price Target and Macquarie's Quantitative Alpha model.

Two rankings: Local market (United States) and Global sector (Utilities)

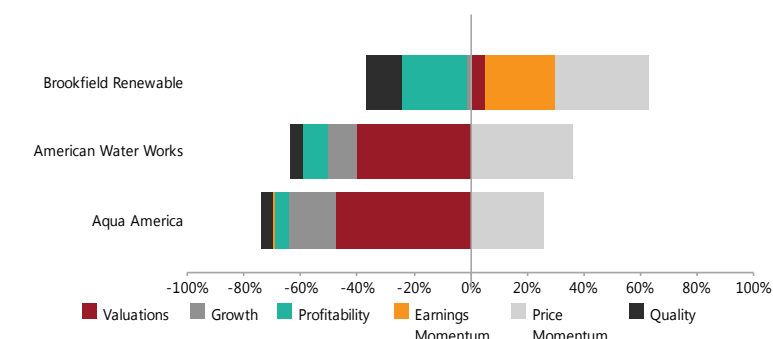
Macquarie Alpha Model ranking

A list of comparable companies and their Macquarie Alpha model score (higher is better).



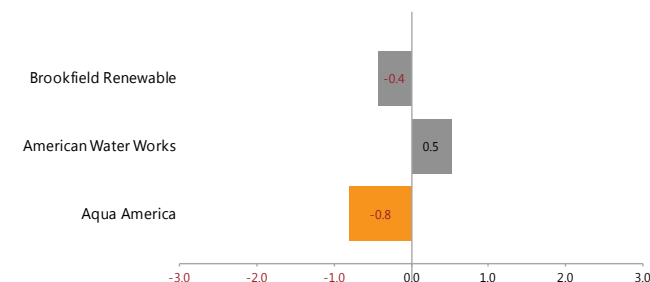
Factors driving the Alpha Model

For the comparable firms this chart shows the key underlying styles and their contribution to the current overall Alpha score.



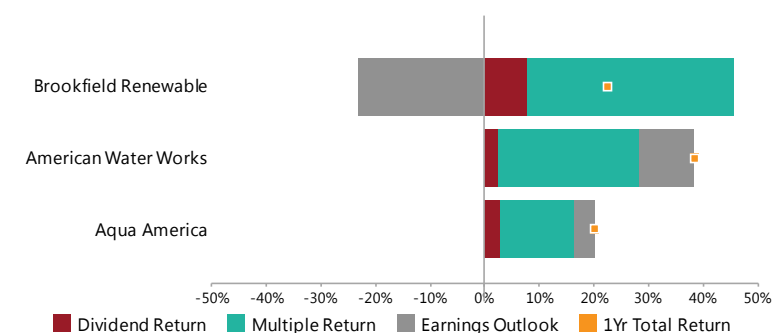
Macquarie Earnings Sentiment Indicator

The Macquarie Sentiment Indicator is an enhanced earnings revisions signal that favours analysts who have more timely and higher conviction revisions. Current score shown below.



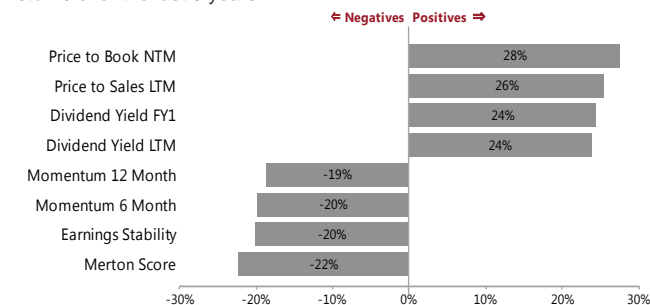
Drivers of Stock Return

Breakdown of 1 year total return (local currency) into returns from dividends, changes in forward earnings estimates and the resulting change in earnings multiple.



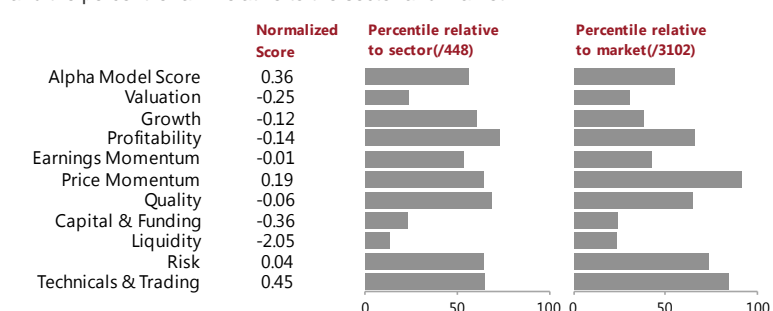
What drove this Company in the last 5 years

Which factor score has had the greatest correlation with the company's returns over the last 5 years.



How it looks on the Alpha model

A more granular view of the underlying style scores that drive the alpha (higher is better) and the percentile rank relative to the sector and market.



Source (all charts): FactSet, Thomson Reuters, and Macquarie Quant. For more details on the Macquarie Alpha model or for more customised analysis and screens, please contact the Macquarie Global Quantitative/Custom Products Group (cpg@macquarie.com)

8 August 2019

Important disclosures:

Recommendation definitions

Macquarie – Asia, USA, Europe and Mazi Macquarie (SA):

Outperform – expected return >10%
 Neutral – expected return from -10% to +10%
 Underperform – expected return <-10%

Macquarie - Australia/New Zealand

Outperform – expected return >10%
 Neutral – expected return from 0% to 10%
 Underperform – expected return <0%

Note: expected return is reflective of a Medium Volatility stock and should be assumed to adjust proportionately with volatility risk

Volatility index definition*

This is calculated from the volatility of historical price movements.

Very high–highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low–medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.

* Applicable to select stocks in Asia/Australia/NZ

Recommendations – 12 months

Note: Quant recommendations may differ from Fundamental Analyst recommendations

Financial definitions

All "Adjusted" data items have had the following adjustments made:

Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
 Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / efpowa*

ROA = adjusted ebit / average total assets

ROA Banks/Insurance = adjusted net profit / average total assets

ROE = adjusted net profit / average shareholders funds

Gross cashflow = adjusted net profit + depreciation

*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

Recommendation proportions – For quarter ending 30 June 2019

	AU/NZ	Asia	RSA	USA	EUR	
Outperform	47.41%	58.03%	49.38%	52.16%	51.95%	(for global coverage by Macquarie, 3.22% of stocks followed are investment banking clients)
Neutral	36.30%	29.24%	32.10%	42.65%	40.69%	(for global coverage by Macquarie, 3.02% of stocks followed are investment banking clients)
Underperform	16.30%	12.74%	18.52%	5.19%	7.36%	(for global coverage by Macquarie, 0.96% of stocks followed are investment banking clients)

WTR US vs S&P 500, & rec history



(all figures in USD currency unless noted)

AWK US vs S&P 500, & rec history



(all figures in USD currency unless noted)

Note: Recommendation timeline – if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.
 Source: FactSet, Macquarie Research, August 2019

12-month target price methodology

WTR US: US\$41.00 based on a PER methodology

AWK US: US\$121.00 based on a Sum of Parts methodology

Company-specific disclosures:

WTR US: The primary analyst has not visited this company's material operations and development assets within the past year.

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Date	Stock Code (BBG code)	Recommendation	Target Price
01-Jul-2019	WTR US	Neutral	US\$38.50
22-Apr-2019	WTR US	Neutral	US\$36.50
06-Mar-2019	WTR US	Neutral	US\$35.50
20-Feb-2019	WTR US	Neutral	US\$35.00
24-Oct-2018	WTR US	Neutral	US\$34.50
05-Mar-2018	WTR US	Neutral	US\$36.00
12-Dec-2017	WTR US	Neutral	US\$38.50
18-Oct-2017	WTR US	Neutral	US\$35.00
11-Apr-2017	WTR US	Neutral	US\$33.00
18-Jan-2017	WTR US	Neutral	US\$32.00
21-Jul-2016	WTR US	Neutral	US\$35.00

Target price risk disclosures:

WTR US: Our US\$41 TP is based on 25.9x our proforma '21 water EPS and 22.2x proforma '21 gas EPS. Risks include: regulatory conditions for the Peoples acquisition, outcomes of pending and future rate cases, especially in PA, cost controls, municipal M&A, and the level of market interest rates.

AWK US: Our US\$121 TP is based on our 2021 SOTP. Risks to the downside include: the slower pace of future municipal acquisitions, lower cost efficiencies, and slower growth in non-regulated operations.

Sensitivity analysis:

Clients receiving this report can request access to a model which allows for further in-depth analysis of the assumptions used, and recommendations made, by the author relating to the subject companies covered. To request access please contact insights@macquarie.com.

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